Yield Climb Resumes on Inflation Concerns

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The bond market selloff returned this morning as inflation expectations continue to rise. Higher bond yields, combined with concerns over equity valuations, have pushed growth stocks lower in early trading.

This morning, the ADP employment report indicated U.S. companies hired fewer employees in February than expected…although freezing temperatures probably contributed to the miss. Last month, ADP data showed a meager +117k increase in payrolls, well below the +205k expected gain. The number of goods producing jobs actually fell by -14k, while service sector jobs rose by +131k. This probably reflects cautious reopening of service businesses in response to a welcomed decline in new virus cases during the month.

In other news from this morning, mortgage applications ended a three-week skid with a +0.5% increase for the week ending February 26th. The Mortgage Bankers Association reported new purchase applications were up +1.8% last week following a -11.6% drop in the previous week, while refi apps rebounded from a -11.3% decline with a +0.1% gain. Roughly two-thirds of last week's applications were refinancings. With the average 30-year mortgage loan rate up 30 bps since the year began, the refi window may be closing for some, but the overall housing outlook for 2021 remains bright.

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The ISM non-manufacturing index unexpectedly dropped from 58.7 to a nine-month low of 55.3 in February. Although the above-50 reading still reflects expansion, purchasing managers complained of supply shortages and labor constraints while grappling with freezing temperatures in many parts of the country. The median forecast was for the overall index to remain near a two-year high. There were significant drops in key components, most notably the current production, which fell from 59.9 to 55.5 and new orders, which plunged from 61.8 to 51.9. The prices paid index continued its ascent, climbing from 64.2 to 71.8. The service sector has been the missing piece in the recovery, but is expected to rebound sharply this summer.

On Monday, the February ISM manufacturing report indicated U.S. factories entered the year on solid ground. The headline manufacturing index climbed from 58.7 to a 10-year high of 60.8. The new orders index rose from 61.1 to a very strong 64.8, while current production jumped from 60.7 to 63.2, and order backlogs climbed from 59.7 to 64. The employment index was above the 50 mark for the third straight month, rising from 52.6 to 54.4. On the inflation side, input prices are rising. The ISM prices paid index moved from 82.1 to 86. Much of this reflects higher energy prices in January, but materials prices are also moving higher. It's hard to discount inflation expectations when PMs are signaling a sharp rise in input prices.

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Late yesterday, the annualized pace of U.S. vehicle sales slowed from 16.6 million to 15.7 million units in February. For comparison, annual sales were above 17 million units every year from 2015 through 2019. In 2020, sales dropped to just over 15 million. If the strong economic growth story plays out later this year, auto sales could easily take off, and the bigger issue might be depleted dealer inventories.

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President Biden made a concession to his $1.9 trillion pandemic relief package, agreeing to lower the income eligibility level for $1,400 payments from $100,000 to $80,000 for individuals, and $200,000 to $160,000 for couples. Given the recent economic improvement, expected second half boom, massive sidelined cash and an already bloated national debt, this seems prudent.

The freeze had a negative impact on February data, but the U.S. economy is improving much quicker than expected. The Atlanta Fed's GDPNow measure for the first quarter jumped to 10% on Monday after the strong ISM release. With the inflation outlook rising, the proposed amount of additional fiscal stimulus is being questioned and concessions are already being made. The Fed has pledged to hold its accommodative policy steady, but the financial markets aren't so sure.

Market Indications as of 11:20 A.M. Central Time

DOW	Up 70 to 31,461 (HIGH: 31,962)
NASDAQ	Down 169 to 13,190 (HIGH: 14,095)
S&P 500	Down 13 to 3,857 (HIGH: 3,934)
1-Yr T-bill	current yield 0.07%; opening yield 0.07%
2-Yr T-note	current yield 0.15%; opening yield 0.12%
5-Yr T-note	current yield 0.74%; opening yield 0.66%
10-Yr T-note	current yield 1.48%; opening yield 1.39%
30-Yr T-bond	current yield 2.26%; opening yield 2.19%